UNITED NATIONS CONFERENCE ON TRADE AND DEVELOPMENT

THE LEAST DEVELOPED COUNTRIES 1993-1994 REPORT

UNITED NATIONS

OVERVIEW

by the Secretary-General of UNCTAD

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OVERVIEW

BY THE SECRETARY-GENERAL OF

UNCTAD

In roughly one quarter of the Least Developed Countries recent experience has been encouraging, with per capita output rising somewhat during the 1990s. Despite this, for the LDCs as a whole per capita income has declined each year since the adoption of the Programme of Action for the Least Developed Countries for the 1990s. This decline increasingly translates into poorer caloric intakes, increased mortality and morbidity, lower school enrolment, deeper immiserization of the weakest members of societies, and other signs of acute social distress.

In most countries the response to these difficulties has been a vigorous effort of policy reform, which is going forward under difficult circumstances. Some of the reforms are starting to bear fruit. It was anticipated that they would be underpinned by a substantial increase in external financial support. This, however, has not materialized to the extent necessary, with adverse effects on the speed and effectiveness of the reform process.

The marked deterioration in human welfare that has occurred in many countries is closely associated with difficulties in effectively mobilizing and deploying resources to meet essential social needs, especially in the key areas of education and health care. Policy reforms can be expected to help enhance resource availabilities. Even within present resource restrictions, however, there is considerable potential for improving social expenditure policies. Here again, there needs to be more effective external support, as regards both the direct provision of essential social services and the process of reform that will strengthen local capacities to deliver such services.

It is a disturbing fact that a growing number of LDCs are experiencing political and civil strife increasingly associated with armed conflict, massive population displacements and a breakdown in the instruments of governance. Under these circumstances domestic development efforts are at best diminished, and external assistance is focused on humanitarian aid, with decreased emphasis on meeting the requirements of longer-term development. Bringing such conflicts to a rapid and peaceful solution is clearly a prerequisite for progress toward the objectives of the Programme of Action in the countries concerned.

Recent Growth Performance of LDCs

The economic performance of the LDCs has improved somewhat, but, overall, continues to be dismal. Their growth of output in 1993 reached about 2 per cent, up from an estimated 0.4 per cent in 1992. Assuming normal weather conditions, growth for LDCs as a whole may reach 2.8 per cent in 1994.

The economic situation of African LDCs has continued to deteriorate, with virtually all major economic indicators reflecting a poor performance. Aggregate GDP growth is estimated to have been negative in 1992 for the third consecutive year; estimates for 1993 and projections for 1994 indicate that, while the decline has halted, growth has scarcely been resumed. In some countries continuing military action has severely disrupted traditional economic activity, resulting in substantial and prolonged declines of output. In such circumstances external assistance must often be directed toward emergency humanitarian aid, rather than development assistance. Yet even such emergency aid often proves difficult to deliver: critically needed food relief operations - some of them designed to benefit large numbers of displaced persons and refugees - have been disrupted due to the persistence of civil strife and armed conflict. In others political instability has been undermining internal and external efforts

devoted to restructuring and bringing about economic recovery. Such countries are also experiencing negative rates of output growth.

For the African LDCs weather conditions continue to dominate the current economic situation, as agriculture is the most important, and at the same time the most erratic, sector of their economies. The economies of southern Africa in particular were seriously damaged in 1992 by severe drought, while in 1993 the food situation worsened in many African LDCs owing to unstable climatic conditions.

For Asian LDCs as a whole, output is estimated to have grown by 4.7 per cent in 1993, a higher rate than in the previous year. Provided weather conditions are normal, growth in 1994 should continue at about the same rate. Patterns of growth differed among countries, in large part as a function of weather conditions and their impact on agricultural output. Their varying performance also reflected the extent to which they were able to cope with internal difficulties, such as political and social instability, and the effectiveness of economic policy reforms. Large population groups in some of these countries continue to suffer from acute poverty, and unemployment remains high in most cases.

While the overall picture remains extremely bleak, there are none the less some welcome signs of progress -- even if halting -- in approximately one quarter of the LDCs. Their experience is marked by a revival of growth, a deepening of the reform process and a strengthened capacity for governance. They are also generally the countries where greater progress has been made in securing popular participation and respect for human rights. Their example serves to keep alive the conviction that, despite the many setbacks and overall lack of progress, the problems facing LDCs can be successfully addressed through adequate domestic and international policies.

The poor recent economic performance of most LDCs has taken a terrible toll. The fall in per capita output translates directly into reduced calorie intakes, increased mortality and morbidity, lower school enrolment ratios and further immiserization of women and children, the weakest members of their societies. A key issue is the apparent inability of many countries to improve -- and in some cases even to sustain -- the provision of essential social services, in particular health care and education. This not only impinges directly on the human condition, but also jeopardizes countries' future development, which must necessarily be based on the capacity to work and the acquired skills of their populations.

Issues relating to the provision of education and health care are closely related to broader questions of resource mobilization and utilization. The process of policy reform under way in most countries is directed at improving both the mobilization of resources and the efficiency of their use, thereby allowing countries to improve their growth performance and accelerate development. External assistance is essential both to support directly efforts to improve the availability of essential services and to underpin the process of policy reform -- in particular fiscal reform -- that will enhance endogenous capacities to expand such services.

Education and Health Care in LDCs

Few development policy objectives command as much support and consensus as the promotion of improved education and health services. And yet education and health experts, not to mention the public at large, lament - with considerable justification - the underfunding of investment in these sectors and the poor quality of the services provided. In view of the clear evidence of the major social and economic benefits associated with investment in human resources, it is a matter of more than passing interest to ask why the apparent consensus in this area is not reflected in higher public expen-

ditures on, and the improved provision and operation of, these services. It is true that choices among priorities are particularly difficult in LDCs, where a narrow productive base limits the resources that can be allocated to any particular activity, whatever its intrinsic merits. This, however, is only part of the explanation. The experience of a number of other developing countries suggests that social improvements can be achieved through active policy intervention even when per capita incomes are relatively low: there are examples of low-income countries where progress in prolonging life expectancy, reducing infant mortality and enhancing literacy rates has been as marked as in certain upper middle-income countries. One of the key conclusions in Part Two of this Report is that there is a considerable potential for improving social expenditure policies in LDCs without detriment to other important areas of expenditure.

A second set of reasons for the relatively poor performance of LDCs with respect to education and health derives from some of the characteristics of the services concerned. Expenditure thereon has externalities that produce particularly high economic and social rates of return in LDCs. Since these will not be fully taken into account by individual consumers, adequate levels of expenditure will be forthcoming only if there are judicious and well-conceived programmes of public intervention, especially by local authorities.

Governments of LDCs will also need to give greater priority to health and education on account of demographic trends. As mortality rates decline there will be a rise in the proportion of dependents in the total population and consequently a progressive increase - over the next few decades at least - in claims on social services, most notably for schooling and health facilities. Inasmuch as performance in LDCs is well below that of other developing countries in areas such as school enrolment ratios, there is much catching up to be done simply to reach the levels of literacy and primary health care prevailing in other developing countries. The lessons of

development experience suggest that no society has undergone industrial growth and structural transformation without a significant rise in the level of literacy. That low levels of literacy and poverty coincide on the world map is not fortuitous. Likewise, the positive correlation between an enhanced status and better education for women, on the one hand, and lower fertility, on the other, is incontrovertible: more educated mothers have fewer and healthier children, as better education demonstrably helps in the understanding of such matters as family planning and health preservation. Moreover, a literate labour force is also a more productive one.

In the light of their limited resources and of their peoples' pressing needs, Governments need to accord greater priority to ensuring the existence of adequate financing, competent management and skilled personnel for the delivery of primary health care and primary education. Most LDCs will need to expand their services dramatically in terms of the number of people served and areas covered. Moreover, the quality of the services will need to be enhanced in respect not only of their social and cultural adequacy but also of their efficacy and accessibility. In many cases, the expansion and intensification of services could be achieved by mobilizing community efforts and tapping local expertise. Primary education and health care need to be provided free of charge; the onus is on the Government and / or on established non-profit groups traditionally providing social services to make this possible.

Beyond the primacy of basic educational and health facilities, Governments need to devise ways of sustaining middle-level and higher education and health facilities. Without some allocation of resources to the secondary and tertiary social sectors, it will be impossible for Governments of LDCs to manage their own policies and develop professional and research autonomy in a longer-term framework. Here, obviously, a broader spread of possible methods needs to be

considered, ranging from local government and community participation in maintaining facilities and providing salaries, through user fees to recover part of the costs involved, to privatization of some components of the health and education systems, thereby freeing resources for use by other components.

The task of ensuring a minimum of basic education and health services will require a significant reallocation of existing resources as well as the provision of new funds. Given the low expenditure ratios and the low absolute levels of funding available for education and health, it is obviously of crucial importance that scarce funds should be allocated efficiently and to priority areas. Further responsibilities in the provision of social services should also be judiciously apportioned between the Government and non-government sectors. Governments will need to define a better public-private-sector interface: while the public sector needs to remain the dominant provider of education and health services in the LDCs, local communities, non-governmental organizations and private commercial firms also have a role to play.

Special levies or taxes that are earmarked for particular health or education expenses could also be considered. Cost-efficiency procedures could include tying arrangements for access to tertiary level education, student loans, or graduate taxes that would apply to professionals trained at government expense. The possibility of instituting appropriate cost-sharing mechanisms as a source of supplementary funding also deserves attention. Cost contributions might take the form of partial user charges, user charges for special services, or, in the case of health, various forms of insurance. User charges are more acceptable when the revenue generated effectively contributes to financing an improved coverage and quality of the services in a specified area, subject to monitoring and control by the communities concerned.

Domestic revenue will clearly not be enough to meet the health and education needs of LDCs, so the role of external financing remains important. While some of the multilateral financial institutions have recently been giving increased priority to the social sector and to primary services in particular, external financing for this sector in LDCs does not seem to have received all the attention it deserves. A notable development, however, is the greater attention now being given by donors to education and health in the provision of aid. To give these approaches a practical meaning, it would be important for donors to integrate education and health concerns more effectively into their policy dialogue with LDCs, provide aid on a longer-term basis, extend support to recurrent and local expenditure, and involve NGOs and local communities more closely.

Policy Reforms and Donor Support

In pursuing their efforts at adjustment and policy reforms, LDCs will continue to depend critically on ODA. However, past experience is far from encouraging: There has been little improvement in overall ODA flows to LDCs since 1990, and the aid outlook continues to be uncertain, due to the stringent budget situation in most donor countries. If LDCs are to succeed in implementing policy reforms in a sustained manner, their efforts need to be underwritten by a substantially increased and more predictable flow of external finance. Besides the provision of the requisite quick disbursing assistance to facilitate stabilization and short- to medium-term adjustment measures, ODA would need to be linked more closely to long-term socio-economic objectives. Moreover, improvements in aid coordination and aid quality should continue to be made in order to enhance the effectiveness of ODA, and aid practices and modalities should be better adapted to the special requirements and circumstances of individual countries. There also needs to be increased exter-

nal assistance designed to strengthen LDCs' capacities to withstand general and unforeseen exogenous shocks, including substantially enhanced actions in the areas of, *inter alia*, debt, trade and commodities.

The external debt burden remains heavy for the large majority of LDCs. In particular, the share of multilateral debt in total long-term debt, as well as debt service, has grown considerably. There are various trade-offs involved in the area of external debt and financing. If the objective is to safeguard the preferred status of the multilateral financing institutions, then effective reduction of other obligations, i.e., official bilateral and commercial debt, will go a long way toward strengthening their capacity to service their growing indebtedness to those institutions. Another important trade-off is between debt relief, additional financing and expanded export opportunities. Unless adequate support for LDCs' growth and development efforts is provided in the last two areas, their payments problems and debt relief requirements are likely to subsist or further increase in the near future.

The evolution of policies in LDCs in recent years reveals a remarkable similarity between their overall development concerns and the emerging aid policy conditionalities of the major bilateral donors. Beyond this general convergence, however, there is the anxiety felt by LDCs that meeting in full the concerns of different donors could exceed their weak institutional and managerial capacities. It would be important to narrow down the mutual concerns of LDCs and donors, to maximize the complementarities of their respective objectives and to take into account the specific context of individual LDCs, including their existing human and institutional capacities. This would be critical for LDCs' ownership of the reform agenda as well as for its credibility and sustainability.

Domestic Policy Reforms

LDCs have been broadening the scope and accelerating the pace of economic reforms since the mid-1980s. Over time, the objectives of the reforms have become both more complex and more ambitious as they shifted from narrow concerns with macroeconomic imbalances and stabilization to promoting growth through multifaceted market-oriented reforms designed to improve economic efficiency and to reduce public sector intervention in the interests of encouraging private investment and enterprise.

The economic reforms have invariably proved painful and have imposed hardship on various social groups. They have thus severely tested the political leadership, which must persist in unpopular policies, often in the face of stiff resistance. The economic and political costs of such reforms might have been more tolerable had they led to results that moved LDCs further along the path of their long-term development aspirations. But this has not yet generally been the outcome. Despite considerable success in stabilizing their macroeconomic imbalances, most countries have witnessed simultaneous drops in per capita incomes, exports and living standards. The reforms, moreover, do not appear to have promoted structural change: supply constraints in agriculture and diversification seem to have been widely immune to the measures adopted.

Unsatisfactory reform outcomes must be attributed in part to shortcomings in policy design: many programmes tended to focus almost exclusively on price incentives without giving sufficient attention to the effects of market failure and structural barriers on development; they also failed to give adequate attention to conflicts between instruments designed to achieve stabilization through reduced absorption and those needed to increase capacity and investment to elicit a supply response. Successful reform will require major changes in

programme design in order to give greater prominence to development objectives, notably the alleviation of poverty, food security and, above all, diversification of the economy. Special measures are necessary to protect the social services vital to sustaining welfare and promoting the development of human capital.

The implementation of reform programmes also shows that, in the final analysis, the quality of public intervention in guiding change is of far greater importance than its scope. Encouraging the private sector often requires the Government to take a leading role in fostering the growth of credit markets, infrastructure, research and extension services. The experience of reform in LDCs has also highlighted the need for government intervention to structure markets so as to counter the distortionary effects of market failures and their potential for resource diversion from priority sectors. Support for capacity building in managing reform remains a key objective of public sector policies. Finally, the capacity of Governments to sustain reforms and their ultimate credibility will depend on the availability of finance to cushion the impact on vulnerable groups and to assure early results in terms of growth.

Fiscal Reforms

In the context of structural adjustment programmes, many LDCs have over the past several years sought to rationalize public expenditure while enhancing public revenue through tax reforms. The ultimate objectives of such reforms are to secure an efficient tax system that can ensure a predictable and adequate level of public revenue with the minimum of administrative problems and economic distortions.

The immediate and most pressing concern of fiscal reforms during most of the 1980s was the reduction of unsustainable macroeconomic imbalances. While fiscal adjustment in a

number of countries benefited from higher levels of revenue as a result of tax reforms, the brunt of adjustment in most other countries took the form of compression of expenditure, particularly development spending. The vulnerability of social expenditures to cuts has been an issue of particular concern to LDCs, given their very low levels of human development. Expenditure compression - whether on social or economic infrastructure - is clearly inconsistent with longer-term development, and stymies the growth of the human, physical and institutional capacities that would allow economies to respond to new opportunities and changing incentives.

The harmful consequences of relying on expenditure compression - particularly in the social sectors - have become the driving force behind recent tendencies to shift the emphasis towards revenue enhancement and expenditure prioritization. As regards revenue, a major source of concern is the continued heavy dependence on trade taxes, despite progress in trade liberalization. Thus, while the introduction, in many countries, of the value added tax (VAT) is intended to diversify the sources of revenue away from trade taxes, pragmatic difficulties in collecting the tax at the wholesale and retail levels have confined its implementation to the manufacturing and import stages. Thus, tax revenues in many LDCs remain vulnerable to fluctuations in the balance of payments.

There none the less remains considerable scope for enhancing revenue and rationalizing expenditure. On the revenue side, the tax base can be further broadened by bringing the services and utilities sector into the VAT tax net; over the longer term, it would be necessary to extend it to the wholesale and retail stages. On the expenditure side, more needs to be done to improve coordination between recurrent and development budgets through improvements in accounting and information flows. Better project appraisal and selection and stricter controls in their monitoring would help to reduce waste and improve aid utilization. The need to reduce tax

evasion and poor tax compliance have highlighted the importance of improving a whole range of tax-related administrative skills, including budget planning, monitoring and control of expenditures. Better tax collection and enforcement will also require a strengthening of the information base on taxpayers as well as increasing the awareness of the general public and of tax collectors of the intricacies of implementing new taxes.

Trade Liberalization

LDCs, which account for 10 per cent of world population, remain on the periphery of world trade: they have experienced a severe squeeze on their trading opportunities in recent years, and their export earnings in 1992 were no higher than in 1980. Their continuing reliance on the export of primary commodities is a major factor explaining this trend.

To expand output and exports and to diversify in favour of manufactures, a growing number of LDCs, particularly in Africa, have resorted since the early 1980s to trade liberalization and currency devaluation. The impact of these measures on exports and economic performance has in most cases been mixed. Generally speaking, countries in Asia have performed relatively well, partly owing to the economic dynamism of the region, whereas in Africa results have been disappointing.

The experience of the LDCs reveals no clear and systematic association between trade liberalization and currency devaluation, on the one hand, and growth and diversification of output and exports, on the other. In fact, a number of countries that undertook substantial liberalization and devaluation experienced falls in industrial output and increased concentration on production and exports of primary commodities. In a limited number of countries where exports of manufactures expanded significantly, the expansion was seldom accompanied by the establishment or expansion of sup-

ply capacity in modern industries. The experience of a number of Asian LDCs which undertook selective, rather than generalized, trade liberalization, suggests that several other factors, including the effective implementation of reforms outside the trade sphere, also played a role in the positive results obtained.

The design of trade policy reforms has been partly responsible for poor economic performance. Inadequate attention to special socio-economic and structural conditions of the LDCs, including their low level of development and narrow industrial base, and unfavourable external conditions in the 1980s and early 1990s, go far to explain the limited efficacy of trade policy reforms. In particular, orthodox recommendations for such reforms neglected to take into account the limitations that market forces have in LDCs for bringing about rapid changes on the supply side.

The experience of LDCs with respect to trade liberalization suggests the need for approaches that take better account of the specific needs, level of development, industrial base and structural characteristics of each country. It also suggests that there is a case for development-oriented expansion of supply capacity, which might comprise liberalization of trade for some goods with, at the same time, a strengthening or easing of the degree of protection for others.

To succeed, the design of trade policy measures will require complementary efforts, particularly in the mobilization of financial and human resources. It will equally necessitate strengthening the capacity of the public sector to formulate and implement policies, and remedy market as well as government failures. The likely degree of success will also depend in part on the external trading environment. The agreements reached at the Uruguay Round of Multilateral Trade Negotiations have significant implications for the trade of LDCs. It will be important to make a comprehensive assessment of the outcome in the light of the LDCs' concerns

and areas of interest, and to ensure that any possible negative consequences are mitigated through appropriate actions, including additional trade preferences, ODA, debt relief and compensatory financing.

Conclusion

In the absence of sustained international solidarity in favour of LDCs, the danger of their increased immiserization is very real, as are the prospects of further socio-political destabilization, increased migration and environmental degradation. From their vantage point, the notion of solidarity embodied in the Programme of Action continues to offer a major window of hope for their economic and social transformation. For these hopes to be realized, however, the LDCs and their partners urgently need to intensify and combine their efforts in a spirit of genuine solidarity to reverse the socio-economic decline and restart the development process without delay. The mid-term global review of the Programme of Action in 1995, decided upon by the General Assembly at its forty-eighth session, will also offer a unique opportunity for LDCs and their partners to agree on ways and means of enhancing and expediting the implementation of national actions and international support measures in order to provide LDCs with renewed prospects for development. I trust that the international community, in UNCTAD and elsewhere, will spare no effort in making thorough preparations for this conference and for ensuring its success.

K.K.S. Dadzie
Secretary-General of UNCTAD

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